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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1940.

No. 1058

FRANK C. RAND,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Eighth Circuit, and

SUPPORTING BRIEF.

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IN THE

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OCTOBER TERM, 1940.

No. .....

FRANK C. RAND,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Eighth Circuit.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Frank C. Rand, respectfully prays that a writ of certiorari issue to review the judgment and decree of the United States Circuit Court of Appeals for the Eighth Circuit, entered in the case entitled "Frank C. Rand, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent," being Cause No. 11,701, on the docket of said Circuit Court of Appeals, which judgment, entered on January 13, 1941 (R. 378), affirmed a decision (order of redetermination) of the United States Board of Tax Appeals entered on September 21, 1939 (R. 44-45), deciding that there are deficiencies in income taxes due

from petitioner for the year 1934, in the amount of $24,008.61, and for the year 1935, in the amount of $33,267.62. A petition for rehearing filed on January 28, 1941, was entertained by said Circuit Court of Appeals, and denied on April 10, 1941 (R. 407).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, § 1, 43 Stat. 938 (28 U. S. C. A., § 347).

QUESTIONS PRESENTED.

Concerning the Addition to Petitioner's Income of the Income of Six Separate Trusts Which Was Used to Pay Life Insurance Premiums.

The tax deficiencies sustained by the Board of Tax Appeals and by the Circuit Court of Appeals, were based upon the application (claimed by petitioner to have been erroneous) of Section 167 (a) (3) and (b) of the Revenue Act of 1934, to the following findings of undisputed facts: That in 1934 and 1935, petitioner as trustee of six separate trust estates created by him in 1926, for his six children, respectively, had used trust income to pay premiums on annual premium payment policies of insurance on his life, applied for by him as such trustee, and payable to the respective trust estates; that long prior to said tax years, petitioner had irrevocably parted with all individual beneficial interest in the principal and income of the trust estates, none of which was used for his benefit; that the trust instruments did not expressly authorize the trustee to use trust income to buy life insurance, but granted the powers "ordinarily possessed by trustees," and power "to invest" trust funds and "to purchase securities or other property"; that petitioner's said use of trust in-

come to pay life insurance premiums occurred only after conference with the children, five of whom were then adults, and with the consent or ratification of all his children; and that in so using trust income, petitioner did not intend to evade taxes on his own income, and did not evade any such taxes, his income from his own property having been no less and no greater as the result of said use of trust income. Upon said facts:

(1) The first question presented involves an important question of constitutional law, viz.: whether Section 167 (a) (3) and (b) of the Revenue Act of 1934 (designed to stop defined methods of income tax evasion), if held to apply to the instant case, would be unconstitutional in imposing a tax on petitioner in respect of income that belonged not to him but to the six separate trusts, thereby imposing a burden unrelated to privilege or benefit and taking petitioner's property without due process of law in violation of Article V of the Amendments to the Constitution of the United States.

The constitutional issue is whether the fundamental concept that one can be taxed only upon income that is his, must be relinquished in the instant case, or whether, as an alternative, Section 167 should be construed as not applicable here, thereby avoiding the question and conclusion of unconstitutionality—a construction which would not impair the full constitutional application of the statute to the tax evasions described in *Burnet v. Wells*, 289 U. S. 670—tax evasions at which Congress aimed, the instant case not being one of tax evasion.

(2) Another question presented is one of construction: whether by Section 167 (a) (3) and (b) of the Revenue Act of 1934, Congress intended to treat as a tax evasion, the use of trust income for the purchase of insurance upon a grantor's life, in a case where the trust instrument did

not disclose an intent to evade by containing express provisions authorizing such use; i. e., absent express authority given by the provisions of the trust instrument, does the mere fact that trust income was used to buy life insurance on a grantor's life, cause the above section to apply and to result in individual tax liability of the grantor for the income so used; or, must both facts co-exist, viz.: express authority so to use trust income, and actual use, in order that the statute may cause such tax liability to result? May such authority be implied from the fact that the same individual was both grantor and trustee?

(3) A further question presented—also one of construction—is: Whether said Section 167 (a) (3) and (b) is to be construed as imposing tax liability on the grantor-trustee, where, as here, the grantor did not act alone—did not exercise sole discretion—but acted in conjunction with the beneficiaries of the trusts, who were consulted and who consented to and ratified the use of their trust income for the purchase of the insurance—they having the "substantial adverse interests" referred to in said Section 167 (a) (3) and (b).

Concerning the 1934 Item of Deduction for Loss on Sale of Shares in Reorganization Investment Company.

(4) Another question presented, in relation to the year 1934 only, is whether a taxpayer may, upon bona fide sale of his beneficial interest in stock of a corporation, be denied a deduction for a loss so sustained on the ground that the stock had become worthless in a prior year, when under the undisputed facts of the case the corporation was a going concern, having operating profits in the taxable year and was not insolvent either in the bankruptcy sense or in the equity sense.

STATUTES INVOLVED.

The federal statutes here involved are:

Section 167 (a) (3) and (b) of the Revenue (or Income Tax) Act of 1934 [26 U. S. C. A., Title 26, "Internal Revenue Acts 1924 to Date," pages 727-728], which reads:

> **"Sec. 167. Income for benefit of grantor.**
>
> "(a) Where any part of the income of a trust * * *
>
> "(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor [except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called 'charitable contribution' deduction]; then such part of the income of the trust shall be included in computing the net income of the grantor.
>
> "(b) As used in this section, the term 'in the discretion of the grantor' means 'in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question.'"

Section 23 (e) of the Revenue Act of 1934 [26 U. S. C. A., Title 26, "Internal Revenue Acts 1924 to Date," p. 672], which reads:

> "Sec. 23. In computing net income there shall be allowed as deductions:
>
> "(e) *Losses by individuals*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> "(1) if incurred in trade or business; or
>
> "(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *."

SUMMARY STATEMENT OF MATTER INVOLVED.

Concerning the Addition to Petitioner's Income of the Income of Six Separate Trusts Which Was Used to Pay Life Insurance Premiums.

The facts undisputed and as found by the Board of Tax Appeals may be summarized as follows:

Since 1920, petitioner's family consisted of his wife and their six children. Impressed by the fact that, upon the death intestate of petitioner's predecessor as president of a shoe company, a son upon attaining majority would come into a substantial fortune, and wishing to avoid a situation of that kind, petitioner determined to form trusts for his own children, all of whom were then minors and none of whom owned any property (R. 31).

On various dates between 1920 and 1926, petitioner caused securities to be issued to himself as "natural guardian" for his respective children (R. 31). Petitioner's intent in constituting himself natural guardian was to convert the guardianships into trusts for the children when he could determine upon the permanent form of such trusts (R. 31).

In 1926, shortly before the majority of his oldest son, petitioner created six separate trusts for the benefit of his respective children, making himself trustee, and caused the securities theretofore held by him as "natural guardian" for each child to be transferred to himself and his successor or successors, as trustee of that trust of which such child was the beneficiary (R. 31-32).

The provisions of the trust instruments, so far as here pertinent, are common to all of them (R. 32). At stated times, portions of the trust principal (ultimately all of it) were in the case of each trust to be turned over to the

designated beneficiary thereof (R. 32). The trusts were irrevocable (R. 32). No part of the income of the trusts was available to petitioner, but, on the contrary, it was expressly provided that it be invested, accumulated or paid to or for the benefit of the respective children (R. 32). The petitioner reserved no interest of any kind in the trust principal or income (R. 106-131).

The trust instruments expressly conferred upon the trustee the usual powers "to invest" trust funds, and "to purchase securities or other property" in addition to the powers "ordinarily possessed by trustees," without any mention of purchasing life insurance (R. 32-33).

Petitioner never used any of the income of the guardianship estates or of the trust estates for the benefit of himself or for his wife, or for the support, maintenance, or education of the children (R. 31, 34). Prior to or during 1934, all of the children, except one, became of age (R. 31).

Prior to 1934, none of the income or principal of the trust estates had been used for the purchase of life insurance (R. 33). In 1934, and for several years previous, there had been accumulations of trust income (R. 33). Petitioner as trustee found it difficult to determine what investments he could advantageously make at that time due to the uncertainty of general market conditions (R. 33). In view of this, petitioner thought a good safe investment could be made in a substantial amount of life insurance, which was later applied for in 1934, and taken out by him, not individually, but as trustee, and made payable to the trustee of the several trusts (R. 33).

While the Board's findings do not refer to the fact, it was indisputably established by the evidence (R. 75), admitted in the argument before the Court of Appeals, and accepted as a fact throughout the case, that petitioner, prior to making any purchases of life insurance, sought

and obtained the consent ("approval") of the children (Opinion of Court, R. 375), all of whom, since 1935, "have paid the premiums on the insurance policies out of their own separate property" (Opinion of Board, R. 33-34). The total protection provided by these policies aggregated $1,000,000.00 (R. 33). The proceeds of all of the policies were made payable to Frank C. Rand, or his successors in said trusts, as trustee for his respective children, and, pursuant to the trust instruments were primarily for the benefit of the respective children. In instances when the right to change beneficiary existed, it was exercisable only by the trustee (R. 33).

Petitioner, as trustee, and out of the income of the trusts, applied $63,927.53 to the payment of premiums upon the policies of insurance on his life during 1934, and $61,606.70 during 1935 (R. 33).

The Commissioner endeavored to charge petitioner with the entire income of the six trusts (R. 37).

On petitioner's appeal to the Board of Tax Appeals, it held that only so much of said income as had actually been used to pay such insurance premiums, should be taxed to petitioner (R. 38).

Concerning the 1934 Item of Deduction for Loss on Sale of Shares in Reorganization Investment Company.

The following facts are undisputed of record:

In 1931 Lorenzo E. Anderson and Company, a partnership engaged in the stock brokerage business, went into receivership. Reorganization Investment Company, a corporation, was formed with new capital by a group of large creditors of the brokerage company to take over the latter's obligations and liquidate its assets (R. 34). Pursuant to a plan of reorganization approved by the court in the

receivership proceeding (R. 199), Reorganization Investment Company acquired the assets and proceeded to liquidate them and to settle the claims of creditors.

Petitioner and members of his family had been creditors of Lorenzo E. Anderson and Company to the extent of approximately $665,000.00 (R. 34). At the time of the organization of Reorganization Investment Company, petitioner subscribed $847,166.67 to its capital for which he received certificates of beneficial interest for 847 1/16th shares of its stock (R. 34).

As a result of the contributions of cash capital and the orderly liquidation of the assets of the partnership, Reorganization Investment Company, prior to 1934, discharged the claims of all creditors of the partnership (R. 84), excepting those of certain "deferred creditors" who had in 1931 agreed to subordinate their claims to those of the general creditors and to postpone payment thereof (R. 187, 190).

The remaining assets were in a frozen condition and of indeterminate value. Among such assets were $695,000.00 in principal amount of bonds secured by mortgage on the "Arena," an exhibition building, located on fifty-two acres of land, which had cost $2,750,000.00, and on a leasehold of an amusement park known as "Forest Park Highlands" (R. 84, 85). During 1934 the company acquired the mortgaged properties at foreclosure sale (R. 85).

In 1934 Reorganization Investment Company had no substantial liabilities, excepting accounts with "deferred creditors" which were not payable excepting out of funds received in liquidation of assets (R. 214, 88). There never was a time in its existence when it was unable to meet its debts as they matured (R. 88). Its capital stock, per books, had a net worth of $205,894.62 (R. 214). Although it had sustained large capital losses as a result of its liquidation,

a pro forma statement of its operations for the year 1934 disclosed that, after excluding such nonrecurring losses, and including income from the operations of the Arena and Forest Park Highlands for the entire year, it had an operating income of $37.018.32 (R. 86). It had reasonable expectations, justified by the experience of subsequent years (R. 213), of continuing to operate at a profit until ultimate liquidation was achieved.

In 1933 petitioner had sold certificates of beneficial interest in 500 shares of stock in Reorganization Investment Company (which had cost him $500,000.00) for the net sum of $4.00. He claimed and was allowed a deduction on this account in his income tax return for that year (R. 34). On December 27, 1934, petitioner sold certificates of beneficial interest for 12 shares (which had cost him $12,000.00) at a price of 10¢ per share (R. 34). As a result of such sale petitioner parted with his entire beneficial interest in the stock and neither he nor any member of his family then or thereafter ever re-acquired or acquired such stock (R. 94, 98).

OPINIONS AND RULINGS BELOW.

The opinion of the United States Board of Tax Appeals (R. 29-39), is reported as *Rand v. Commissioner*, 40 B. T. A. 233.

The opinion of the Circuit Court of Appeals (R. 369-378), is reported as *Rand v. Helvering*, 116 F. (2d) 929. Its rulings included the following:

Concerning the Addition to Petitioner's Income of the Income of Six Separate Trusts Which Was Used to Pay Life Insurance Premiums.

(A) Although the Circuit Court of Appeals in its opinion did not specifically discuss or rule upon the contention

in petitioner's brief, that if Section 167 (a) (3) and (b) of the Revenue Act of 1934 were held to apply to the instant case, the statute would be unconstitutional in imposing a tax upon petitioner in respect of income that belonged, not to him, but to the six separate trusts, thereby imposing a burden unrelated to privilege or benefit, and taking his property without due process of law—the Circuit Court of Appeals impliedly denied said contention by holding that the statute applies to the instant case (R. 377). The Board of Tax Appeals in its opinion had expressly overruled said contention (R. 37).

(B) The Circuit Court of Appeals in its opinion (R. 374) held that the mere fact that trust income was in fact applied by petitioner to the payment of premiums on policies of insurance on his life, caused Section 167 (a) (3) of the Revenue Act of 1934 to apply to the instant case and to render such income taxable to petitioner.

(C) The Circuit Court of Appeals held (R. 377), that although the trust beneficiaries, who had substantial adverse interests in such disposals of trust income, either approved or ratified the act of petitioner (grantor-trustee) in using trust income to pay premiums on policies of insurance on his life, petitioner is liable under Section 167 (a) (3) for an income tax on the trust income so used (R. 372).

(D) The Circuit Court of Appeals held (R. 376), that "petitioner as an individual had an interest in the policies," notwithstanding the undisputed facts found by the Board of Tax Appeals: that the trusts were irrevocable; that the policies of life insurance were taken out by petitioner as trustee of the respective trusts for his children; that the proceeds of all the policies were payable to petitioner as trustee or to his successor in trust for the trust beneficiaries; that the right to change the beneficiary was

exercisable by the trustee; and notwithstanding the fact that neither the trust instruments nor the policies, nor any other evidence proved, or tended to prove, that petitioner as an individual had any interest in the policies.

Concerning the 1934 Item of Deduction for Loss on Sale of Shares in Reorganization Investment Company.

(E) The Circuit Court of Appeals held (R. 377-378) that: Petitioner could not in 1934 take a deduction for a loss upon sale by him of his beneficial interest in 12 shares of stock in Reorganization Investment Company, because he himself had established that the stock became worthless prior to 1934 by selling similar interests in 1933 for a nominal consideration.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

Concerning the Addition to Petitioner's Income of the Income of Six Separate Trusts Which Was Used to Pay Life Insurance Premiums.

I. The United States Circuit Court of Appeals—in holding that the taxpayer might be taxed, under Section 167 (a) (3) of the Revenue Act of 1934, upon income of the six separate trusts because of the mere fact that, years after the creation of the trusts, income of the trusts was used (without any relation to the original purposes of the trusts, and without any intent to evade taxes) to pay premiums on policies of insurance on the life of the grantor—gave an interpretation to said Section that would render it unconstitutional as imposing a tax upon one person with respect to the income of another (a burden unrelated to privilege or benefit); and has thus decided a federal question in a way probably in conflict with the applicable decisions of this Court in *Hoeper v. Tax Commission of Wisconsin,*

284 U. S. 206, at 215, and *Burnet v. Wells*, 289 U. S. 670, at 681.

The further reasons below stated bear upon the proposition that said statute, when properly construed, was not applicable to the instant case, and the Circuit Court of Appeals, in not construing the statute so as to avoid an interpretation which would render it unconstitutional or cast grave doubts upon its constitutionality, decided a federal question in a way probably in conflict with applicable decisions of this Court in *Lucas v. Alexander*, 279 U. S. 573, at 577, and *United States v. Delaware and Hudson Company*, 213 U. S. 366, at 407-408.

II. The United States Circuit Court of Appeals—in holding: (1) that the mere fact that trust income was applied to the payment of premiums on policies of insurance on the life of the grantor, caused Section 167 (a) (3) of the Revenue Act of 1934 to apply and to render petitioner individually liable for income taxes on the part of the income so used; and in holding (2), that although the Rand trust instruments contained no express provision directly bearing on the question whether trust income could be used to buy life insurance, such authority could and must be implied from the later conduct of the grantor-trustee in so using trust income—has decided [by holding (1) supra] important questions of federal law in a way probably in conflict with an applicable decision of this Court in *Burnet v. Wells*, 289 U. S. 670, and has decided [by holding (2) supra] an important question of federal law which has not been, but should be, settled by this Court; and has rendered a decision in conflict with the decisions of two other Circuit Courts of Appeals on the same point, that such authority must be expressly reserved in the trust instrument and therefore cannot be implied. *Higgins v. White*, 93 F. (2d) 357, at 359; *Commissioner v. Waterbury*, 97 F. (2d) 383, at 386.

III. The United States Circuit Court of Appeals—in holding in the instant case, that although the trust beneficiaries, who had substantial adverse interests in such disposition of trust income, consented to or ratified the act of the trustee in using trust income to pay premiums on policies of insurance on his life, Section 167 (a) (3) of the Revenue Act of 1934 applied, and made petitioner liable for an income tax on the trust income so used—has decided an important question of federal law which has not been, but should be, settled by this Court.

IV. The United States Circuit Court of Appeals—in finding and holding: (1) that "petitioner as an individual had an interest in the policies," although said conclusions were without any supporting findings by the Board and were contrary to the undisputed evidence; and in holding (2) that Section 167 (a) (3) of the Revenue Act of 1934 was intended to apply to cases, as here, when no individual benefit resulted to petitioner from the use of trust income to buy life insurance upon his life for the benefit of the trust beneficiaries—has decided federal questions in a way probably in conflict with applicable decisions of this Court in *Burnet v. Wells*, 289 U. S. 670, and in *Central Bank of Washington v. Hume*, 128 U. S. 195, at 206.

Concerning the 1934 Item of Deduction for Loss on Sale of Shares in Reorganization Investment Company.

V. The United States Circuit Court of Appeals—in holding that stock in Reorganization Investment Company had become worthless prior to 1934, although during that year the company was a going concern earning operating profits (after elimination of non-recurring capital losses), and was not insolvent either in the bankruptcy sense or in the equity sense—has rendered a decision in conflict with the decisions of other Circuit Courts of Appeals on the same

point, to the effect that worthlessness cannot be attributed to stock under such circumstances.

Olds & Whipple v. Commissioner of Internal Revenue, 75 F. (2d) 272, 275 (C. C. A. 2);
Coalinga Mohawk Oil Co. v. Commissioner of Internal Revenue, 64 F. (2d) 262, 263 (C. C. A. 9);
Deeds v. Commissioner of Internal Revenue, 47 F. (2d) 695, 696-7 (C. C. A. 6).

PRAYER.

For the purpose of correcting the errors complained of, and to the end that the rights of petitioner may be determined in accordance with the law, your petitioner respectfully prays: that a writ of certiorari be issued under the seal of this Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding it to certify and send to this Court, on a day certain to be therein designated, a full and complete transcript of the records and proceedings of said Circuit Court of Appeals in the above-described case, to wit, Frank C. Rand, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent, No. 11,701, Tax Review, on the docket of said Court, to the end that the decision of said Circuit Court of Appeals in said cause may be reviewed by this Honorable Court as provided by law; that said decision be so reviewed by this Court, and that your petitioner may have such other and further relief as to this Court may seem appropriate.

FRANK C. RAND,
Petitioner,

By DANIEL N. KIRBY,
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SUPPORTING BRIEF.

I. OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 29-39) is reported as *Rand v. Commissioner*, 40 B. T. A. 233. The opinion of the Circuit Court of Appeals (R. 369-378) is reported as *Rand v. Helvering*, 116 F. (2d) 929.

II. JURISDICTION OF THIS COURT.

The judgment of the United States Circuit Court of Appeals was entered on January 13, 1941 (R. 378). The petition for rehearing (R. 379-406), filed on January 28, 1941, was entertained by said Court and denied on April 10, 1941 (R. 407). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, § 1, 43 Stat. 938 (28 U. S. C. A., § 347).

III. STATEMENT.

A full statement of the case has been made in the foregoing petition for writ of certiorari, to which, for brevity, reference is hereby made without repetition.

IV. SPECIFICATIONS OF ERROR.

(1) The Circuit Court of Appeals erred in the instant case, in not holding that Section 167 (a) (3) and (b) of the Revenue Act of 1934, if applied to the instant case, would be unconstitutional in taxing petitioner on income that belonged, not to him, but to the six trust estates; and also erred in not avoiding the conclusion of invalidity by holding that the application of said statute should be confined to the class of cases described in the Congressional declaration of its purpose, tax evasions, which class does not include the instant case.

(2) The Circuit Court of Appeals erred in holding in the instant case, that the mere fact that trust income was applied to the payment of premiums on policies of insurance on the life of the grantor, caused Section 167 (a) (3) to apply and to render petitioner individually liable for income taxes on the part of the income so used.

(3) The Circuit Court of Appeals erred in holding that although the Rand trust instruments contained no express provisions directly bearing on the question whether trust income could be used to buy life insurance, such authority could and must be implied from the later conduct of the grantor-trustee in so using trust income; and that therefore the trust instruments impliedly authorized such use.

(4) The Circuit Court of Appeals erred in the instant case, in not holding: that because petitioner, in deciding whether to use trust income for the purchase of insurance on his life, did not exercise the discretion "alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question," but acted in conjunction with, and pursuant to the consent, or with the ratification, of, the trust beneficiaries, who had substantial adverse interests in the disposition of their trust income so used; therefore, by the clear, unambiguous provisions of subsection (b) of Section 167 the instant case is outside the scope and purpose of said statute.

(5) The Circuit Court of Appeals erred in not holding that the use by petitioner of trust income to purchase and maintain life insurance on his life, conferred on him as grantor no benefit or privilege adequate to sustain as constitutional the application of Section 167 (a) (3) of the Revenue Act of 1934.

(6) The Circuit Court of Appeals erred in holding that "petitioner as an individual had an interest in the policies."

(7) The Circuit Court of Appeals erred in holding that stock in Reorganization Investment Company might be treated as having become worthless prior to 1934, although the company was, at all times during the taxable year and thereafter, a going concern with operating profits, and with properties having a value in excess of its liabilities, and was at no time unable to meet its debts as they matured.

(8) The Circuit Court of Appeals erred in holding that petitioner was not entitled to take a deduction in 1934 on account of loss sustained by him upon sale in that year of said shares of stock.

V. ARGUMENT.

Point I. In Support of Reason I for Allowance of Writ.

The Circuit Court of Appeals erred in the instant case, in not holding that Section 167 (a) (3) of the Revenue Act of 1934, if applied to the instant case, would be unconstitutional in taxing petitioner for income that belonged, not to him, but to the six trust estates; and also erred in not avoiding the conclusion of invalidity by holding that the application of said statute should be confined to the class of cases described in the Congressional declaration of its purpose, tax evasions, which class does not include the instant case.

As construed and applied to the instant case, by the Board of Tax Appeals and the Circuit Court of Appeals, Section 167 (a) (3) of the Revenue Act of 1934, means that a grantor-trustee must be taxed individually for such portion of the income of the trust as is applied by him to the payment of premiums on insurance upon his life, although: (a) the trust instrument did not expressly authorize the purchase or maintenance of such insurance; (b) the trusts had been in existence for more than eight years before the insurance was applied for; (c) the admitted purpose (recognized by the Board and Court) of buying life insurance was only to invest trust income safely; (d) the insurance was purchased with the express consent or the ratification of the trust beneficiaries who had "substantial adverse interests" in the disposition made of the trust income; (e) the grantor had no individual proprietary interest in either the corpus or income of the trust estate; and (f) he derived no individual benefit from the purchase or maintenance of the policies, because he had not applied for them in his name, they were not his con-

tracts, he was not "a party" to them and could not have enforced them, being merely the person whose life was insured (*Central Bank of Washington v. Hume*, 128 U. S. 195, l. c. 206; 37 C. J., page 603, par. 387).

The effect of taxing in such a case is to impose arbitrarily a burden unrelated to benefit or privilege, and to tax one person in respect of income that belongs to another.

The issue sharply presented is whether Section 167 (a) (3), if interpreted as in the instant case, can be upheld constitutionally, or whether, in the alternative and to avoid the contention and conclusion of unconstitutionality, the statute may and should have been construed in such manner that its validity would be saved. *Lucas v. Alexander*, 279 U. S. 573, l. c. 577; *United States v. Delaware & Hudson Company*, 213 U. S. 366, l. c. 407-408.

The general proposition is clear that an attempt to tax one person in respect of income belonging to another, is violative of the Fifth Amendment to the Constitution. *Hoeper v. Tax Commission of Wisconsin*, 284 U. S. 206, l. c. 215. What was true in the *Hoeper* case under the Fourteenth Amendment in respect of income taxed by the states, must necessarily be true under the Fifth Amendment in respect of income taxed by the United States.

That Section 167 (a) (3) and (b) is valid as applied to the kind of cases to which the Congress intended it, has been held in *Burnet v. Wells*, 289 U. S. 670, and is not sought to be questioned here. This Court there reviewed the legislative history of the statute, finding that its scope and justification rested in the declared purpose of Congress to prevent evasions of income taxes in the class of cases described in the Court's following quotation from the Report of the Committee on Ways and Means of the House:

"Trusts have been used to evade taxes by means of

> provisions allowing the distribution of the income to the grantor or its use for his benefit. The purpose of this subdivision of the bill is to stop this evasion" (*Burnet v. Wells*, 289 U. S., at 675).

Using this congressionally declared purpose as a guide in its interpretation of the statute, this Court held that the statute was intended to apply in a case where a grantor (Wells) had contracted for insurance in his own name, for the benefit of persons some of whom were his minor dependents, and had then created a funded trust for the express purpose of maintaining such insurance. Trust income not only *was* so used, but *was required by the express provisions of the trust to be so used.* The case was within the class of tax evasions intended by the Congress to be stopped, because the terms of the trust *expressly "allowed"* (in fact required) trust income *to be used* for the benefit of grantor, and because it *was* so used (*Burnet v. Wells*, 289 U. S. 670, l. c. 673-674). The case was likened by the Court to one in which a taxpayer created a trust for the express purpose of budgeting the payment of his own obligations (*Burnet v. Wells*, 289 U. S., l. c. 682).

The constitutional validity of the statute was made to rest on the existence of benefits to the grantor (Wells), in that the policies to be maintained by the trust income were "his contracts," based upon applications for the insurance made in his individual name, thus creating privity of contract, and resulting in contracts that he could enforce in equity (*Burnet v. Wells*, 289 U. S., l. c. 679-680); also upon the fact that some of the beneficiaries were legally dependents of the grantor (*Burnet v. Wells*, 289 U. S., l. c. 680-681).

The Court recognized that Section 167 (a) (3) might not be upheld in all cases, saying (*Burnet v. Wells*, 289 U. S., l. c. 681):

"The exceptional, if it arises, may have its special rule."

We respectfully submit that the instant case is such an exception, upon the facts found by the Board and assumed by the Circuit Court of Appeals.

This is so, First: because the instant case does not fall within the Congressionally declared purpose of the statute. The trust instruments did not contain express "provisions allowing" the use of trust income to buy life insurance on grantor's life.

It is so, Second: because the instant case does not come within the purview of Section 167 (a) (3), as construed and defined in *Burnet v. Wells,* which contemplates cases in which provisions of the trust instruments expressly "allow" such use of trust income.

To be within said purview, the trust instrument must contain provisions allowing the use of trust income for the benefit of grantor. This necessarily means provisions expressly allowing such use, because:

> "In a trust inter vivos, a power reserved to a grantor must be by express words of reservation." *Higgins v. White,* 93 F. (2d) (C. C. A. 1) 357, l. c. 359.

The opinion of this Court in *Burnet v. Wells,* 289 U. S. 670, contains repeated statements mentioned later herein, indicating that the power to so use trust income must be found in the express provisions of the trust instrument.

It is so, Third: because none of the benefits upon which the Court rested the constitutionality of the statute in *Burnet v. Wells,* 289 U. S. 670, exist in the instant case.

It is so, Fourth: Because both the Board and Court recognized that Rand's sole purpose in buying the insurance was to make a safe investment of trust income, a pur-

pose which necessarily excluded any intent to evade taxes on his own income.

It is so, also: because the express provisions of subparagraph (b) of Section 167 clearly exclude the instant case from the scope of the section, the grantor's discretion in deciding whether to buy life insurance having been exercised not alone, but in conjunction with the trust beneficiaries who had "substantial adverse interests" in the disposition of the part of the income in question. The Circuit Court of Appeals did not even quote or allude to subsection (b) and its provisions with respect to discretion of persons having an adverse interest.

When life insurance was first purchased in 1934, it was done as the Board found, because petitioner found it difficult to select other safe investments. It was not done pursuant to any purpose existing at the time of the creation of the trusts, or later, to use the trusts as a means of evading petitioner's income taxes by obtaining or maintaining insurance for petitioner's own benefit. It is significant that when the insurance was thus purchased, four of the children were of age, another would become of age in a few months, and as to those not of age, petitioner provided for their maintenance, support and education out of his own funds. Hence, there could have been no purpose of providing for the support of dependents during minority. The purchase of insurance was merely a substitute for investments in bonds and stocks, and under the facts found, it is arbitrary to treat the income used to buy insurance differently from the way in which it would have been treated if used for the purchase of securities.

The fact that the trust beneficiaries consented to the use of the income for that purpose virtually shifted from petitioner to the beneficiaries the responsibility for what was done, and renders the purchase, in effect, the act of the

beneficiaries. Had such consent not been obtained, there would have been an unauthorized and nonlegal use of trust income. The fact of consent legalized such use.

It is respectfully submitted, that in not holding that Section 167 (a) (3) and (b) of the Revenue Act of 1934, if construed to apply to the instant case, would be unconstitutional in imposing a tax on petitioner in respect of income that belonged, not to him, but to the six separate trusts, thereby imposing a burden unrelated to privilege or benefit, and taking petitioner's property without due process of law in violation of Article V of the Amendments to the Constitution of the United States; and that in failing to hold that, to avoid the constitutional question, the statute should be construed as not applicable in the instant case, although validly applicable to cases like *Burnet v. Wells*, 289 U. S. 670—the Circuit Court of Appeals has decided a federal question in a way probably in conflict with the applicable decisions of this Court above cited.

Point II. In Support of Reason II for Allowance of Writ.

(1) *The Circuit Court of Appeals erred in holding in the instant case* (R. 374), *that the mere fact that trust income was applied to the payment of premiums on policies of insurance on the life of the grantor, caused Section 167 (a) (3) to apply, and to render petitioner individually liable for income taxes on the part of the income so used.*

In support, the Court cited *Heffelfinger v. Commissioner*, 87 F. (2d) 991, and *Pillsbury v. Burnet*, 67 F. (2d) 151, neither of which is in point, because in both, the trust instruments contained express provisions authorizing or directing the use of trust income for the payment of premiums on life insurance policies on the life of the grantors.

Heffelfinger v. Commissioner, 87 F. (2d) 991, at 992; *Pillsbury v. Burnet*, 67 F. (2d) 151, at 151.

We respectfully submit that the decision of the Circuit Court of Appeals in the instant case, that *the mere fact* that trust income *was applied* to the payment of premiums on policies of insurance on the life of grantor, was sufficient to cause Section 167 (a) (3) to apply by making the grantor individually liable for the amounts of the income so used, is probably in conflict with the applicable decision of this Court in *Burnet v. Wells*, 289 U. S. 670, to the effect that in order to make the statute applicable, it must appear not only that trust income was so used, but also that authority for such use was expressed in the trust instrument.

For the foregoing reasons it is respectfully submitted: that in the instant case the Circuit Court of Appeals has decided the federal question involved in the construction and application of the federal statute here involved, in a way probably in conflict with an applicable decision of this Court in *Burnet v. Wells*, 289 U. S. 670, at 681.

(2) *The Circuit Court of Appeals erred in holding* (R. 375) *that although the Rand trust instruments contained no express provision directly bearing on the question whether trust income could be used to buy life insurance, such authority could and must be implied from the later conduct of the grantor-trustee in so using trust income, and that therefore the trust instruments impliedly authorized such use.*

While we have found no decision of this Court directly in point, to the effect, that in order to make Section 167 (a) (3) applicable in a case where the grantor-trustee has in fact used trust income for the purchase of insurance on his life, the authority to do so must have been *expressedly*

reserved or granted in the trust instrument, and *cannot be implied,* we respectfully submit: that said conclusion is implicit in the purpose of the statute as declared by the Congress, and in the reasoning of the opinion in *Burnet v. Wells,* 289 U. S. 670, construing the statute; and that it has been so decided by two other Circuit Courts of Appeals, cited later.

The question is important because it has appeared in several cases before the Board of Tax Appeals, and seems to have been controlling against petitioner in the instant decision of the Circuit Court of Appeals, that the mere use of trust income for such purpose brings the statute into effect, and that authority to use, need not be expressly reserved or granted, but may be implied from the subsequent conduct of the grantor-trustee.

Turning to the congressional declaration of purpose, above quoted, it shows that the statute was intended to stop a particular kind of income tax evasions, viz.: the use of trusts funded by grantors as instrumentalities or devices to evade income taxes that would otherwise have fallen on the grantors.

By what means were such evasions being accomplished? The Congress said "By *means of provisions allowing* the distribution of *the income* to the grantor or *its use for his benefit.*"

What "provisions" are referred to? Obviously provisions contained in the written trust instruments; provisions that expressly "allowed" such distribution to grantor, or such use for his benefit.

Clearly the Congress did not intend to stop uses of trust income "not allowed," that is, not expressly directed or authorized to be made, by the provisions of the particular written trusts.

Since these Rand trusts contained no express "provisions allowing" the use of trust income to buy insurance on his life, it follows that the instant case is not within the purpose or scope of the statute, and the Circuit Court of Appeals erred in not so holding.

This contention is in harmony with the reasoning in the opinion in *Burnet v. Wells*, 289 U. S. 670.

Concerning the intent of the grantors who are sought to be taxed by the statute, in relation to its purpose, the opinion pointed out that the Wells trusts had been created for the express purpose of providing that trust income was to be used to pay the premiums on life insurance policies on the grantor's life. The Court said that in effect, this was saying to the trustee that for the rest of Wells' life "he would dedicate part of his income to the preservation of these contracts, * * *" (*Burnet v. Wells*, 289 U. S., at 680).

The grantor (Wells) had said this by "provisions" in his trust conveyances expressly authorizing and directing the trustee to so use trust income.

No such situation exists in respect of these Rand trusts. His trust instruments did not expressly reserve or give any such power to the trustee.

The opinion also recognized that the actual use of trust income is necessary to render Section 167 (a) (3) applicable in order to keep the policies alive and thereby to confer upon the grantor the benefit upon which the opinion held the tax to be justified, and which saved it from unconstitutionality. The Court said that income "permanently applied by the act of the taxpayer to the maintenance of contracts of insurance made in his name for the support of his dependents is income used for his benefit in such a sense and to such a degree that there is nothing

arbitrary or tyrannical in taxing it as his'' (*Burnet v. Wells*, 289 U. S., at 680-681).

The ''act'' of Wells here mentioned as a permanent application of trust income to maintain his insurance contracts, consisted in his creating the trust and by its express provisions directing the trustee to so apply the trust income. In the Wells case, the trust income was not only authorized and directed to be so used, but it was so used. Absent either fact, there could have been no liability under Section 167 (a) (3).

The Court also recognized, as a necessity, that the authority to use trust income for such insurance premiums, must originate in the trust instrument itself, by saying that trusts to preserve insurance policies ''involve a continuing exercise by the settlor of a power to direct the application of the income along predetermined channels'' (*Burnet v. Wells*, 289 U. S. 670, at 681-682), and that the use to be made of the income of the trust ''was subject, from first to last, to the will of the grantor announced at the beginning'' (*Burnet v. Wells*, 289 U. S. 670, at 682).

The decision of this Court, therefore, implied that Section 167 (a) (3) be read as meaning that there may be taxed to the grantor, only income of a trust which is, *and* in the discretion of the grantor, or of any person not having a substantial adverse interest in the disposition of such part of the income, may be, applied to the payment of premiums upon policies of life insurance on the life of the grantor. This conclusion would be in conformity with that canon of construction whereby the statutory word ''or'' is interpreted to mean ''and''—whenever this interpretation ''is required to carry out the plain purpose of the act * * * and when to adopt the literal meaning would defeat the purpose or lead to an absurd result.'' *State v. Krueger*,

217 S. W. (Mo.) 310, at 315; *Northern Commercial Company v. United States*, 217 F. 33, at 36.

Obviously, annual payment policies of life insurance like those in the instant case (R. 151) can be preserved only through the payment of premiums. If they are not paid, the policies lapse. Therefore, a trust for the preservation of such policies presupposes the actual use of trust income to keep the policies alive. It also presupposes the existence of a power expressly reserved or granted by the trust instrument, pursuant to which the settlor will continue to use trust income to pay the premiums, and implies that such use be made of the trust income "along predetermined channels"—that is, channels predetermined by the express provisions of the trust instrument by which the will of the grantor was therein expressly "announced at the beginning."

Therefore, the intent of the grantor that trust income be used to maintain such insurance must be found in the express provisions of the trust instrument "allowing" such use, and may not be implied.

In the instant case none of the above factors indicated by the opinion in the Wells case as necessary to bring a case within the scope of Section 167 (a) (3) existed, except the fact that some trust income was used to pay premimums on life insurance policies upon the life of the grantor. But the use so made was not pursuant to any express authority reserved by the grantor or granted to the trustee. The legal sanction for Rand's use of trust income to buy the life insurance rested not on any provisions of the trust instruments, but on the consent of the beneficiaries who had substantial adverse interests in such use of their trust income.

That a power validly reserved to a grantor in a trust

inter vivos, must be by express words of reservation, was held by the Circuit Court of Appeals for the First Circuit in *Higgins v. White*, 93 F. (2d) 357, at 359, in relation to what is now Section 167.

The Circuit Court of Appeals for the Second Circuit, also held in *Commissioner v. Waterbury*, 97 F. (2d) 383, at 386, in determining whether Section 167 applied in that case, that a power reserved to a grantor in an inter vivos trust, must be by express words of reservation, and that because there was no express reservation of discretionary power to the grantor in the above case, to divert income from the designated beneficiaries, no occasion existed for the application of Section 167.

The above decisions by said two other Circuit Courts of Appeals are in harmony with established doctrines in the general law of trusts. We omit additional citations and discussions of said doctrines, because the above two decisions prove their conflict with the decision in the instant case.

The decision of the Circuit Court of Appeals in the instant case, to the effect that power reserved to the grantor to use trust income for the purchase of life insurance, may be implied and need not be express, is in conflict with the above two decisions by other Circuit Courts of Appeals.

Point III. In Support of Reason III for Allowance of Writ.

The Circuit Court of Appeals erred in the instant case in not holding: that because petitioner, in deciding whether to use trust income for the purchase of insurance on his life, did not exercise the discretion "alone or in conjunction with any person NOT having a substantial adverse interest in the disposition of the part of the income in

question," but acted in conjunction with, and pursuant to the consent, or with the ratification, of, the trust beneficiaries who HAD substantial adverse interests in the disposition of their trust income so used, therefore, by the clear, unambiguous provisions of subsection (b) of Section 167, the instant case is outside the scope and purpose of said statute.

This contention was made in the briefs and argument for petitioner in the Circuit Court of Appeals, but it was not discussed nor specifically decided, nor even mentioned, although the Court stated (R. 375) that the beneficiaries "either approved or ratified the acts of the trustee." That all the children ratified said use made by petitioner of their income, appears from the finding of the Board, that "Since 1935, petitioner's six children have paid the premiums on the insurance policies out of their own separate property" (R. 33-34).

Neither the Board nor the Court mentioned the facts, undisputed of record and testified to by petitioner, that (R. 75):

> "Before taking out those insurance policies or paying any of the premiums, I consulted with the four older children, with my son-in-law, who happens to be in the insurance business, about making that investment. In that consultation they were informed of the fact that I was proposing to make that investment. I spoke about the total amount of insurance that the Trustee was contemplating taking out and had divided equally among the six children. I did not go into the details as to the amount of premiums that would be involved in the case of each estate or child. I don't know that I told them in detail my purpose in using some of the income of their trust estates for premiums on life insurance policies. I discussed with them the

difficulties of making proper investments and I thought it was to their benefit for me to take out a substantial amount of insurance which they would have to pay. I made it very clear to them that I never expected to pay a dime's worth of these premiums or get any benefit from the insurance. I cannot recall in this connection any further than I have given, but I can say that I have conferred with the children, they were all mature men, my sons; I have conferred with them and am conferring with them about investments made of the trust funds."

The Circuit Court of Appeals not only made no reference to this consultation with the persons having the substantial adverse interest in the disposition of the income, but it did not quote, mention or allude to subsection (b) of Section 167 which excludes this case from the application of the section.

Both the Board and the Court received an erroneous impression of the purpose and legal effect of the contention for petitioner, that power to use trust income to buy life insurance must be expressly reserved or granted in the trust instrument, but was not expressed in the Rand trusts; and that therefore if the beneficiaries had not consented to or ratified petitioner's use of trust income to buy the life insurance, petitioner would have breached his trust. The Board and Court erroneously treated the above contention as an effort by petitioner to assert his own "misconduct and breach of trust, as relieving him from tax liability" (Opinion of Board, R. 37-38; Opinion of Court, R. 375).

We have not contended, as the Court assumed (R. 375), that petitioner sought in the instant case to assert, as the basis for a right, that he had violated his trust. We have not contended that petitioner committed a breach of trust, or should be relieved of tax liability because of any mis-

conduct on his part. On the contrary, we have urged, and still urge, that there was no violation of the trust, no breach of duty, and no misconduct by petitioner in connection with these insurance transactions. Our contention was, and is, that the trust instruments conferred no authority to buy life insurance with trust income, and that if petitioner had purchased it without first obtaining the consent or later ratification of the persons with adverse interests, he would have violated the terms of the trusts and the law of trusts. But since he did secure their consent or later ratification, this act and fact legalized the otherwise illegal and unauthorized use of trust funds. Clearly, the liability imposed by Section 167 (a) (3) and (b) is imposed conditionally—only if the grantor acts on his sole discretion, or if he acts on the joint discretion of himself and disinterested parties.

It is admitted that he gave to the persons having adverse interests in his proposed use of the trust income, the opportunity to assent or dissent. They elected to assent and thereby joined in the exercise of the discretion exercised by petitioner, in deciding to use trust income for the purpose of buying insurance on petitioner's life.

The above undisputed and admitted facts definitely exclude the possibility of any intent by petitioner, in deciding to buy life insurance instead of investing the trust income in stocks and bonds, to commit a breach of trust, or to evade income taxes. No presumption of such intent is possible, because, in asking their consent, he made it clear to his children that they would have to maintain the insurance that he proposed to purchase with trust income, that he, individually, would not pay any of the premiums, and that he would have no interest in the policies.

It would be incongruous to attribute to petitioner an intent to evade income taxes if it be contended that the

legal effect of his conduct would be to increase his income taxes. His conduct, in first consulting the beneficiaries and obtaining their consent, cannot reasonably be considered as evidencing an intent on his part when creating the trusts, more than eight years before he bought the insurance, to reserve to himself or grant to the trustee, power to buy such insurance, when his acts demonstrate that before attempting to thus use trust income, he thought it expedient or necessary to first obtain the consent of the beneficiaries. The fact that he obtained such consent before acting, indicates rather that he did not reserve, or intend by the trust instruments to grant, such authority to the trustee without such consent. We therefore respectfully submit that the Circuit Court of Appeals erred in holding that petitioner's said conduct in 1934 and 1935 affords a sufficient basis for an implied conclusion that in 1926 he intended by the trust instruments to reserve the power to use trust funds to buy life insurance on his own life without the prior consent of the beneficiaries.

The effect upon petitioner's tax liability, of the purchase of the insurance with the consent of the trust beneficiaries, itself negatives the existence of any intent to evade his income taxes through the purchase. His real purpose, found by the Board and adopted by the Court, was to safely invest idle income of the trust estates. He had no thought of evading his income taxes. His admitted purpose excluded intent to evade taxes on his own income. His tax liability in respect of his own income was in no way altered by the purchase of the insurance, either by way of diminution of the gross income that would otherwise be taxed to him, or by increase of deductible items. On the contrary, the effect of the decisions below, is to increase his individual tax liability above what it would have been had no insurance been purchased. There cannot be attributed to petitioner, an attempt to evade taxes,

when it is contended that the necessary effect of what he did, is to increase them.

The effect of the decisions below is to punish petitioner with an income tax liability on $125,534.23 of income of the six estates, because of his lawful conduct in using the trust income in a way that Section 167 (a) (3) and (b) expressly permitted without such tax liability. Surely the Congress did not intend the statute to be construed in any such way.

Having found no case in which this Honorable Court has decided this important question of federal law, involving the meaning of subsection (b), we respectfully submit, that by not holding that—petitioner's conduct in thus using trust income with the consent of his children to buy insurance on his life for the benefit of their trust estates, excluded him, under the express provisions of subsection (b) of Section 167, from liability for income taxes on the amounts of trust income so used—the Circuit Court of Appeals has decided an important question of federal law, which has not been, but should be, settled by this Court.

Point IV. In Support of Reason IV for Allowance of Writ.

The Circuit Court of Appeals erred in not holding that the use by petitioner of trust income to purchase and maintain life insurance on his life, conferred on him as grantor no benefit or privilege adequate to sustain as constitutional the application of Section 167 (a) (3) of the Revenue Act of 1934.

The Circuit Court of Appeals erred in holding (R. 376) *that "petitioner as an individual had an interest in the policies."*

This holding was, notwithstanding the undisputed facts found by the Board of Tax Appeals: That the trusts were

irrevocable; that the policies of life insurance were taken out by petitioner as trustee of the respective trusts for his children (this finding was based upon undisputed evidence that the petitioner had applied for the policies not in his individual name, but in his name as trustee of the respective trusts for his children); that the proceeds of all the policies were payable to petitioner as trustee or to his successor in trust for the trust beneficiaries; that the right to change the beneficiary was exercisable by the trustee; that four of the children were then adults and therefore not dependents of his; and that petitioner provided out of his own funds, for the education, maintenance and support of his minor children; and said holding was, notwithstanding the fact that neither the trust instruments, nor the policies, nor any other evidence proved, or tended to prove, that petitioner as an individual had any interest in the policies. If he had applied for them in his individual name, rather than as trustee for his respective children, he would thereby have created privity of contract between himself and the life insurance companies, and would have been able by suit in equity to enforce the policies, an interest in them that was held by this Court in *Burnet v. Wells*, 289 U. S. 670, at 679-680, to support the constitutionality of the tax.

The Circuit Court of Appeals did not specify in its opinion what kind of interest the Court referred to in its above holding, nor the facts upon which said holding was based.

It is therefore respectfully submitted that since the facts in the instant case show that the benefits existing in *Burnet v. Wells* and upon which the Court there based the constitutionality of Section 167 (a) (3), are entirely lacking in the instant case, the Circuit Court of Appeals in its above finding and ruling, and in ruling that the above statute does apply in the instant case and results in an

income tax liability upon petitioner for the amounts of trust income so used, the Circuit Court of Appeals has decided federal questions in a way probably in conflict with an applicable decision of this Court in *Burnet v. Wells*, 289 U. S. 670.

Point V. In Support of Reason V for Allowance of Writ.

The Circuit Court of Appeals erred in holding that stock in Reorganization Investment Company might be treated as having become worthless prior to 1934, although the company was, at all times during the taxable year and thereafter, a going concern with operating profits, and with properties having a value in excess of its liabilities, and was at no time unable to meet its debts as they matured.

The Circuit Court of Appeals erred in holding that petitioner was not entitled to take a deduction in 1934 on account of loss sustained by him upon sale in that year of said shares of stock.

Reorganization Investment Company was during the taxable year, and now is, a going concern. The book value of its assets exceeded its liabilities. It had never failed to meet its debts as they matured. In fact, it had no substantial liabilities, excepting voluntarily postponed accounts not payable on demand. It was a liquidating company and the amount ultimately payable to its stockholders was dependent upon the realization from assets, among which the chief item was an exhibition building which had cost $2,750,000.00.

No embarrassed circumstances impaired the prospect of the corporation's fulfillment of its original purpose—orderly liquidation of the assets of Lorenzo E. Anderson and Company. Although the nature of its business involved

the taking of capital losses of non-recurrent nature, this did not detract from its ability to continue indefinitely, for it was incurring no operating deficits, but on the contrary enjoying operating income.

The decision of the Circuit Court of Appeals conflicts with the decisions of other Circuit Courts of Appeals which have established the proposition that worthlessness cannot be attributed to stock in a corporation which is not insolvent and which is operating as a going concern. *Olds & Whipple v. Commissioner of Internal Revenue*, 75 F. (2d) 272, 275 (C. C. A. 2); *Coalinga Mohawk Oil Co. v. Commissioner of Internal Revenue*, 64 F. (2d) 262, 263 (C. C. A. 9); *Deeds v. Commissioner of Internal Revenue*, 47 F. (2d) 695, 696-7 (C. C. A. 6).

The sole reason advanced by the Circuit Court of Appeals as sustaining a finding that the stock in question had become worthless prior to 1934 was that the petitioner had sold 500 shares in 1933 for a nominal consideration. What he did in 1933 surely cannot spell the financial death of the corporation nor impair the ability of the corporation to recoup something for its remaining stockholders from the abundant frozen assets on hand. The decision exacts a penalty, in the guise of a tax, for petitioner's having taken in 1933 a loss which he undoubtedly sustained.

The foregoing facts, authorities and argument are respectfully submitted in support of petitioner's prayer that this Honorable Court grant a writ of certiorari in the instant case.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 1058

FRANK C. RAND, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 29–39) is reported in 40 B. T. A. 233. The opinion of the Circuit Court of Appeals (R. 369–378) is reported in 116 F. (2d) 929.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1941 (R. 378). The petition for rehearing filed January 28, 1941 (R. 379–

406), was denied on April 10, 1941 (R. 407). The petition for a writ of certiorari was filed May 15, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the grantor of trusts for the benefit of his children is taxable under Sections 167 and 22 (a) of the Revenue Act of 1934 upon income therefrom applied to payment of premiums on policies of insurance on the life of the grantor taken out by him as trustee for the benefit of the several trusts.

2. Whether there is substantial evidence to support the finding of the Board of Tax Appeals that certain stock became worthless prior to the taxable year, 1934.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 13–19.

STATEMENT

The facts found by the Board of Tax Appeals with respect to the two issues involved are substantially as follows (R. 30–35):

1. The taxpayer is an individual and resides at University City, Missouri. For approximately forty years he has been associated with the International Shoe Company in various positions. In

August 1916, taxpayer was elected president of the company, in which position he served until 1930, when he was made chairman of the board. Since 1920 taxpayer's family has consisted of his wife and their six children (R. 30).

Impressed with the fact that, upon the death intestate of taxpayer's predecessor as president of the company, his son upon attaining his majority would come into a substantial fortune, and being desirous of avoiding a situation of that kind, taxpayer determined to form trusts for his own children, none of whom owned any property and who at that time were all minors. On various dates between 1920 and 1926 taxpayer caused securities to be issued to "Frank C. Rand, natural guardian for," naming the child, the name being followed by the words "a minor donee." Taxpayer's intent in constituting himself natural guardian was to convert the guardianships into trusts for the children when he could determine upon the permanent form for such trusts. Taxpayer, as natural guardian, collected the income of the guardianship estates and kept it separate and apart from any of his or his wife's personal incomes. During this period taxpayer did not use any of the income from the guardianship estates for his own benefit nor did he use any of it to relieve himself from any obligation imposed by law for the maintenance, support, or education of his children. During the minority of the children he provided for their sup-

port, maintenance, and education out of his personal funds. On September 26, 1926, taxpayer's oldest son was to become of age, and on September 15, 1926, taxpayer executed a declaration of trust by which he caused to be transferred to himself, as trustee, the guardianship estate which he had previously held for that child. Similar trusts were created for the other children in October, 1926. All of the trusts, save one, by their terms were irrevocable, and in the one not specifically made irrevocable, there was no provision making it revocable (R. 31–32).

The provisions of the trusts so far as here pertinent are common to all of them. The property was transferred to Frank C. Rand, as trustee, "to hold, manage, and improve said property, with full authority to such trustee to change the investment of the same or any part thereof and to invest or reinvest the proceeds from time to time, with full power to accumulate, invest, change, or reinvest the surplus of any income, dividends and interest from said securities and property, nevertheless for the benefit" of the respective children. At stated times portions of the trust principal were to be turned over to the designated beneficiary and the respective trusts were to terminate on the final distribution of the trust estate (R. 32).

The trust instruments each provided (R. 32–33):

> 1. The trustee shall have the following powers in addition to those hereinbefore

conferred or those ordinarily possessed by trustees:

* * * * *

2. The power to purchase securities at a premium and to charge the premium against principal or against income or partly against income as in the opinion of the trustee may be suitable and appropriate.

3. The power to purchase for cash or on credit securities or other property, and to borrow money from time to time upon such terms as the said trustee may think expedient, upon the security of any of the property of this trust, whether real or personal, and for such purposes to give and execute and acknowledge mortgages, with such powers and provisions as said trustee may think proper, and also to execute and deliver such notes or bonds as it is necessary to use in connection with such transactions.

* * * * *

Taxpayer, as trustee, has kept individual book account records for each of the six beneficiaries of all of the transactions of the trustee, and has kept the trust funds deposited in a bank account known as the "Rand-Six Trusts," and the trustee's books show the separate individual interest of each trust beneficiary (R. 33).

Prior to 1934 none of the income or principal of the trust estates had been used for the purchase of life insurance. In 1934 and for several years previous there had been accumulations of trust in-

come. Taxpayer, as trustee, found it difficult to determine what investments he could advantageously make at that time due to the uncertainty of general market conditions. Substantially the same situation obtained in 1935. In view of this, taxpayer thought a good, safe investment could be made in a substantial amount of life insurance taken out by him as trustee for the benefit of the several trusts. Forty-five separate life insurance policies issued by seven different life insurance companies on the life of taxpayer were taken out in 1934 by taxpayer, as trustee of the respective trusts for his children. The total protection provided by these policies aggregates $1,000,000. The proceeds of all of the policies are payable to Frank C. Rand or his successors in trust, as trustee for his respective children, and, pursuant to the trust instruments, are primarily for the benefit of the respective children. In instances when the right to change beneficiary exists it is exercisable by the trustee (R. 33).

Taxpayer, as trustee, out of the income of the trusts, applied $63,927.53 to the payment of premiums upon the policies of life insurance during 1934, and during 1935 paid $61,606.70 in premiums on the same policies. Since 1935, taxpayer's six children have paid the premiums on the insurance policies out of their own separate property (R. 33–34).

The total income of all of the trust estates for 1934 and 1935 was $322,277.91 and $359,138.20, respectively. The Commissioner included these entire amounts in taxpayer's gross income for 1934 and 1935 (R. 34).

Taxpayer has never used any of the income from the trusts for the direct benefit of himself or his wife, nor has he used it for the support, maintenance, or education of his children (R. 34).

2. The Reorganization Investment Company was organized in 1931 to take over the obligations and liquidate the partnership of Lorenzo E. Anderson & Company, which had been conducting a stock and bond brokerage business in St. Louis, Missouri. Taxpayer and members of his family were creditors of the company to the extent of approximately $665,000. At the time of the organization of the Reorganization Investment Company, taxpayer subscribed $847,166.67, for which he received 847 1/16 certificates of beneficial interest in the stock of the company. (For convenience these certificates of beneficial interest will be hereinafter referred to as stock in the company.) In 1933 taxpayer sold 500 shares of the above stock, which had cost him $500,000, for the net nominal sum of $4. He claimed and was allowed a deduction on this account in his income tax return for that year. On December 27, 1934, taxpayer sold 12 shares of the Reorganization Investment Company stock through St. Louis brokers at the price of ten cents

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per share, which, after deduction of commission, resulted in a net sales price of 22 cents for the 12 shares. This was the stock for which taxpayer paid $1,000 per share in 1931. The balance sheet of the Reorganization Investment Company as of December 31, 1933, shows assets of $1,769,088.83 and liabilities of like amount, including a liability of $48,826.13 in respect of 2,200 shares of capital stock (R. 34–35).

The Board of Tax Appeals specifically found that the stock of the Reorganization Investment Company was worthless prior to 1934 (R. 35).

The Commissioner included in taxpayer's income the total income of the trusts for 1934 and 1935. The Commissioner also denied a deduction from 1934 income in respect of an alleged loss sustained by the taxpayer in connection with stock in the Reorganization Investment Company (R. 18–19, 38).

Upon review the Board of Tax Appeals held that there was properly includible in the taxpayer's gross income only the amount of premiums paid or payable on existing policies (R. 38), but otherwise sustained the Commissioner. The court below affirmed.

ARGUMENT

1. The court below held, correctly, we submit, that the grantor was taxable under Section 167 (a) (3) of the Revenue Act of 1934 (Appendix, *infra*), which provides that where any part of the income

of a trust is applied to the payment of premiums upon policies of insurance on the life of the grantor, then such part of the income of the trust shall be included in computing his taxable net income. The instant case clearly falls within the statute, since the trust income here involved was actually applied to payment of the premiums upon policies of insurance on the life of the taxpayer-grantor. *Burnet* v. *Wells,* 289 U. S. 670; *Rieck* v. *Commissioner,* 118 F. (2d) 110 (C. C. A. 3d); *Heffelfinger* v. *Commissioner,* 87 F. (2d) 991 (C. C. A. 8th), certiorari denied, 302 U. S. 690; *Pillsbury* v. *Burnet,* 67 F. (2d) 151 (App. D. C.) The decision below is not, as contended by petitioner (Br. 21–30), distinguishable from *Burnet* v. *Wells* in any material way.

Cases such as *Higgins* v. *White,* 93 F. (2d) 357 (C. C. A. 1st), and *Commissioner* v. *Waterbury,* 97 F. (2d) 383 (C. C. A. 2d), certiorari denied, 305 U. S. 638, upon which the taxpayer relies (Pet. 13; Br. 31), deal with different situations and statutory provisions; they are not in conflict with the decision below.[1]

---

[1] Moreover, it would seem that the grantors in the *Higgins* and *Waterbury* cases could have been taxed under the gross income provisions of the applicable revenue acts corresponding to Section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*). But those cases were decided prior to *Helvering* v. *Clifford,* 309 U. S. 331, wherein the grantor was held taxable under Section 22 (a) because he retained so many of the attributes of ownership of the trust property as to justify treating him as owner altogether for income tax purposes,

In the court below, we urged as an alternative ground in support of the Board's decision that the trust income in question is also taxable to the grantor under Section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*) because he retained sufficient of the attributes of ownership of the trusteed properties to justify treating him as owner altogether for purposes of income taxation. *Helvering* v. *Clifford, supra.* In *Helvering* v. *Fuller,* 310 U. S. 69, this Court indicated that the grantor might be taxable under the rule in the *Clifford* case, *supra,* where he retained substantial control of the trust property even though the trust was for a term of ten years at the expiration of which the corpus was to be transferred to his divorced wife. Here, the grantor, as trustee, retained substantial control over the trust properties, including the right in his discretion to make payments of income or principal to the children-beneficiaries at any time. Any funds not earlier distributed were to be paid over to the beneficiaries at the expiration of stated periods and the respective trusts were to terminate on final distribution (R. 32, 107).

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and the point was not raised in the *Waterbury* case nor in the earlier proceedings in the *Higgins* case. However, after the *Higgins* case had been remanded to the District Court for further proceedings, the question as to applicability of the gross income provisions was raised and decided in favor of the Government upon the second appeal. *White* v. *Higgins*, 116 F. (2d) 312 (C. C. A. 1st).

2. The court below correctly held (R. 377–378) that there was no basis for the claimed deduction in respect of stock of Reorganization Investment Company, since the evidence supported the Board's finding that the stock in question had become worthless prior to the taxable year. *Helvering* v. *Rankin,* 295 U. S. 123, 131; *Helvering* v. *Kehoe,* 309 U. S. 277.

The taxpayer contends (Pet. 14–15; Br. 38–39) that the decision of the court below conflicts with cases stated to have established the proposition that worthlessness cannot be attributed to stock in a corporation which is not insolvent and which is operating as a going concern. *Olds & Whipple* v. *Commissioner,* 75 F. (2d) 272 (C. C. A. 2d); *Coalinga-Mohawk Oil Co.* v. *Commissioner,* 64 F. (2d) 262 (C. C. A. 9th), certiorari denied, 290 U. S. 637; and *Deeds* v. *Commissioner,* 47 F. (2d) 695 (C. C. A. 6th). But those cases turn on their particular facts and are not in conflict with the decision here. As pointed out in the opinion of the Board of Tax Appeals in the instant case (R. 39), the continued operation of the company would not of itself prove value in its stock, particularly where, as here, the company by its very nature was a liquidating company which would presumably continue to operate until its purpose was fulfilled, even though the final result of its operations could leave nothing for the stockholders.

CONCLUSION

The decision below is correct. There is no conflict. The petition should be denied.

Respectfully submitted.

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MAY 1941.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(U. S. C., Title 26, Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed

only to the extent provided in section 117 (d).

* * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

* * * * *

(U. S. C., Title 26, Sec. 101.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * *

ART. 23 (e)–4. *Shrinkage in value of stocks.*—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 is deductible by the owner for the taxable year in which the stock became worthless, pro-

vided a satisfactory showing is made of its worthlessness. Federal or State authorities incident to the regulation of banks and certain other corporations may require that stock be charged off as worthless or written down to a nominal value. If, in any such case, the basis of the requirement is the worthlessness of the stock, such charging off or writing down will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes of the amount so charged off or written down can be allowed. For dealers in securities, see article 22 (c)–5. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see section 117.

ART. 167–1 [as amended by T. D. 4759, 1937–2 Cum. Bull. 117, and T. D. 4860, 1938–2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation

of such income to the grantor, is whether he has failed to divest himself, both permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantors legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

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